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In the Supreme Court of the United States

OCTOBER TERM, 1956

WILSHIRE HOLDING CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. App. 1-8) are not officially reported. The opinion of the Court of Appeals, issued on October 29, 1955 (Pet. App. 9-18), is reported at 226 F. 2d 798. The memorandum opinion of the Court of Appeals, issued on December 6, 1956 (Pet. App. 19-20), is not officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on December 6, 1956. A timely filed petition for re-

hearing was denied on April 15, 1957. The petition for a writ of certiorari was filed on May 29, 1957. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

In determining whether certain payments made by the taxpayer should be treated as deductible business expenses or nondeductible capital expenditures, the question is whether the agreement pursuant to which such payments were made was a lease or an installment sale contract.

STATUTE INVOLVED

Internal Revenue Code of 1939.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made

as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

STATEMENT

Prior to September 11, 1929, Walburga Oesterreich was the owner of three adjoining vacant lots (552, 553, and 554) at the corner of Wilshire Boulevard and Hamilton Drive in Beverly Hills, California. These lots had an adjusted basis of $24,235.05. (Pet. App. 1-2.)

In 1929, Wilshire Amusement Corporation (predecessor of the taxpayer corporation) was organized for the purpose of building a motion picture theatre. Negotiations were had between Walburga and Wilshire with respect to the use of her land for this purpose. During these negotiations, it was decided that additional land would be needed for the desired theatre. Accordingly, Wilshire purchased lot 555 and part of lot 556 at a total cost of $19,650 and conveyed them to Walburga. The negotiations between Walburga and Wilshire culminated in their execution of an agreement entitled "lease" dated September 11, 1929. (Pet. App. 2.)

In this agreement, Walburga is referred to as lessor and Wilshire as lessee. The agreement provides that the lessor lets lots 552, 553, 554, 555, and part of lot 556 to the lessee for a term of sixty-seven years and eight months. Payments called "rent" are

to be made in monthly installments, at an annual rate of $7,500 for the first ten years, $12,000 for the succeeding eighteen years and in amounts then decreasing to $7,500 in the sixty-eighth year. The lessee agrees to pay all taxes and similar charges on the property and to erect a new building on the premises at a cost of not less than $300,000. The lessor can declare the lease terminated in case of a default continuing longer than a period stated in the lease. (Pet. App. 2-3.) One paragraph of the agreement is as follows (Pet. App. 3-4):

> The Lessor hereby promises and agrees that, upon the expiration of the term of this lease by lapse of time, and when all of the terms and conditions of this lease have been met and all of the rentals and other payments provided to be paid shall have been paid at the times and in the manner provided, the Lessor promises and agrees that she will then, upon the payment to her of the further sum of ten dollars ($10.00) in hand, convey or cause to be conveyed by grant deed to the Lessee free and clear of all encumbrance, all of the real property herein leased, without further or other consideration.

As successor to Wilshire, the taxpayer paid Walburga $12,000 in each of the years 1945 and 1946, in accordance with the provisions of the agreement of September 11, 1929. On its income tax returns for those years, taxpayer deducted these amounts as rental expense. (Pet. App. 5.) The Commissioner issued a notice of deficiencies to taxpayer stating (Pet. App. 6):

> On each of your returns for the years 1945 and 1946 you deducted $12,000.00 as rent paid.

> Inasmuch as the so-called "lease" under which these amounts were paid provides that the demised property shall be deeded to you for a nominal consideration upon the payment of a certain specified sum in monthly installments, including the above amounts, it is held that the monthly payments constitute capital expenditures and the claimed deductions are therefore disallowed.

Taxpayer filed a petition for redetermination in the Tax Court.

A deficiency in the income tax of Walburga having also been determined for the year 1946, she filed a petition for redetermination in the Tax Court, contending that her tax had been overpaid because she had erroneously treated the amounts received from taxpayer as rental income (taxed as ordinary income) rather than installment payments of the purchase price of realty (taxed as capital gain). The cases of taxpayer and Walburga were consolidated for trial. (Pet. App. 1, 19.).

Pointing out that the agreement of September 11, 1929, was called a lease, and that both parties on their books of account and in their tax returns had consistently treated payments under that agreement as rent, the Tax Court sustained the deficiency determined with respect to Walburga but not those determined with respect to the taxpayer. (Pet. App. 7-8.)

A petition for review was filed in Walburga's case and a protective petition for review in taxpayer's case. Pursuant to a stipulation of the parties, proceedings on appeal in taxpayer's case were held in

abeyance pending a decision of the Court of Appeals in Walburga's case. Taxpayer was permitted to file a brief *amicus curiae* in Walburga's case, and at the suggestion of the court, the Commissioner's time for oral argument on that appeal was relinquished to taxpayer. (Pet. App. 19.)

Holding that the agreement of September 11, 1929, was a contract of sale rather than a lease, the Court of Appeals explained that the legal effect of what the parties intended to happen was not changed by how the parties thought that effect should be described or what they may have called the agreement. Accordingly, the Tax Court's decision in Walburga's case was reversed. (Pet. App. 9-18.) Thereafter, the Tax Court's decision in taxpayer's case was, on motion of the Commissioner, also reversed. (Pet. App. 19.)

ARGUMENT

The single issue presented is the proper construction of the agreement of September 11, 1929, between the taxpayer corporation's predecessor and Walburga Oesterreich. Specifically, the questions are (1) whether under that agreement the parties intended that the taxpayer's predecessor would acquire title to the property involved, and (2), if so, what constituted the consideration to be paid for that property. The taxpayer does not contend that its payments to Walburga during the taxable years were deductible as business expenses under Section 23(a)(1)(A) of the Internal Revenue Code of 1939 (*supra* pp. 2-3) if taxpayer either had an equity in the property or was taking title to it. Rather, the taxpayer

merely argues (Pet. 9-22) that the decision that it did have an equity and was taking title is contrary to the law and contrary to the evidence.[1]

As the Court of Appeals noted (Pet. App. 15-16), taxpayer mistakenly relies upon cases involving options to purchase property for substantial sums which may constitute full consideration for the property and which make it impossible to predict with reasonable certainty whether the options will actually be exercised.[2] Here, however, it is virtually indisputable that taxpayer will exercise its right under the agreement of September 11, 1929, to acquire for the token price of $10 land worth $100,000 during the taxable period. Indeed, not only will taxpayer thus acquire valuable land upon the payment of $10, but, if it were not to pay the $10 and take title, it would forfeit to Walburga a building which had cost $350,000. Moreover, by the provisions of the agreement of September 11, 1929, taxpayer can acquire the land and building upon the payment of $10 only when and if all of the so-called rental payments have been made. These provisions and the gross inade-

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[1] Taxpayer's additional contention (Pet. 6-8), that it should have been allowed time for oral argument on the Commissioner's motion to reverse on the basis of the opinion of the Court of Appeals in the companion *Oesterreich* case, loses sight of the fact that taxpayer was afforded ample opportunity to present its arguments in that case through both a brief *amicus curiae* and oral argument.

[2] These cases include: *Benton* v. *Commissioner*, 197 F. 2d 745 (C.A. 5th); *Breece Veneer & Panel Co.* v. *Commissioner*, 232 F. 2d 319 (C.A. 7th); *Haverstick* v. *Commissioner*, 13 B.T.A. 837; *Indian Creek Coal & Coke Co.* v. *Commissioner*, 23 B.T.A. 950.

quacy of $10 as a total purchase price compel the conclusion that the total purchase price includes the so-called rental payments as well as the $10.[3]

Accordingly, in making the so-called rental payments the taxpayer was acquiring title and its equity was increasing with each payment. In so concluding, the Court of Appeals did not reverse the decision of the Tax Court for failing properly to find the evidentiary facts, but rather for failing to recognize the correct test to be applied to those facts—namely, the legal effect of what the parties intended to happen.

CONCLUSION

The decision below is correct. The question is of no general importance. There is no conflict of decisions. It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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[3] We are unable to understand why, as taxpayer seems to suggest (Pet. 22), the total of the so-called rental payments would be too much to pay for possession of the land and building for sixty-eight years and title at the end of that period, but not too much to pay for possession of the land and building for sixty-eight years without title at the end of the period.

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